

***Building confidence:  
Subject matter specialists  
in government contracting  
enhance quality and  
reduce risk***

# *Opportunities abound*





## *How PwC's Government Contracting practice adds value for engineering and construction clients*

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An engineering and construction (E&C) company may find many opportunities in the purchasing appetites of governments. To achieve success in government contracting, however, the company has to digest many challenges.

The US government is the single largest purchaser of goods and services. This activity, combined with the purchasing by state and local governments and the financing arrangements the federal government uses to advance its policies (e.g. reducing dependency on foreign and fossil energy), results in a very attractive market for E&C companies. In addition, during economic downturns, E&C and other companies often look to government-funded projects to maintain or enhance revenue.

Although government-funded projects are excellent pursuits, they often come with significant issues and requirements not generally seen in the commercial market. Management is responsible for understanding these risks and dealing with them. To that end, management must:

- understand the government contracting issues
- develop operational and accounting processes, controls, and monitoring approaches to address the issues
- develop appropriate pricing and negotiation strategies that comply with the government contracting requirements
- maintain a message of compliance from the top.

E&C contractors that can effectively accomplish these tasks can differentiate themselves from their competitors and profit from the numerous government contracting opportunities.





# *Issues facing our clients in the E&C industry*

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E&C firms face many issues working on government contracts:

- Weighing the pros and cons of establishing business units specifically to execute government contracts.
- Developing proposals and pricing that comply with the applicable government contracting requirements.
- Developing pricing and costing associated with change orders, terminations, and claims not only to incorporate strategies to maximize cost recovery, but also to successfully withstand the scrutiny of government audits.
- Identifying key compliance risks and developing successful strategies to alleviate them. The contract compliance requirements and risks include:
  - allowable costs that conform with Federal Acquisition Regulation (FAR) Part 31
  - defective pricing implications resulting from not providing current, accurate, and complete information as required by the Truth in Negotiations Act (TINA)
  - cost measurement and allocation as governed by the Cost Accounting Standards (CAS)
  - reporting and compliance with the Davis-Bacon Act, and other prevailing wage legislation
  - billing and reporting issues that may result in noncompliance with the False Claims Act and False Statements Accountability Act
  - appropriate internal controls, training, and policies to comply with mandatory disclosure requirements
  - conformance with the Buy American Act.
- Verifying adequacy of systems (e.g. billing, labor charging, accounting, material management, procurement, estimating, and earned value) throughout the contract life cycle to comply with government rules and regulations for adequacy of estimating, cost accumulation, and reporting.
- Developing proposals for General Services Administration Federal Supply Schedule contracts, including proper disclosures associated with commercial sales practices; and, once awarded a contract, maintaining the proper processes to monitor compliance with the Price Reduction Clause at FAR 52.215-10, Trade Agreements Act, and Industrial Funding Fee calculations.
- Facilitating government audits, inquiries, and investigations.
- Understanding the rules and regulations that apply to contracts being awarded by for-profit entities or state and local governments that have funding from the federal government including agency loans, loan guarantees, bonds (e.g. Build America Bonds), grants, and cooperative agreements (e.g. Department of Energy-funded battery recycling facilities and smart grid facilities).
- Establishing and implementing appropriate compliance controls including accounting policies and procedures, monitoring mechanisms, and levels of authority.

E&C companies can enhance their success by developing innovative pricing and negotiation strategies to address increased competition, evolving rules and regulations, and significant scrutiny by audit and enforcement agencies.



# *Pinpointing the higher- risk areas*



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Contractors in the E&C industry face a number of issues when dealing with the numerous federal, state, and local government statutes and regulations related to the contract life cycle and business processes. Some of the higher risk or most common issues include contract changes, terminations, accounting system inadequacies and false claims. A summary of the common risk areas are as follows:

*Significant changes to contracts*

Given the size and complexity of their projects, governmental agencies often make significant changes in their contracts. These changes may result from customer delays, differing site conditions, and third-party issues. Failure to file timely change orders or claims for these issues can hurt contractors' chances of receiving fair compensation, thereby reducing their cost recovery and profits. Additionally, if contractors are unable to track change order costs adequately, submit proposals quickly, and engage in timely negotiations with the government, they can suffer delayed cash flow in addition to potentially lower margins on the change orders.

*Terminations*

The fiscal environment has led to increased use of the termination for convenience contract clause. However, terminations for convenience entitle the contractor to recover allowable costs and reasonable profit. Therefore, the government's first approach may be a termination for default, where the government claims the contractor failed to perform. Under this scenario, the contractor is not entitled to allowable costs and reasonable profit and, in some instances, may have liability for the costs required to complete the project. In either type of termination, the timeline and process for settlement of contracts are typically shorter and more urgent than typical contractual activities. As a result, if contractors are unprepared, they may pay the price in the form of smaller cost recoveries or inability to defend against the termination for default.

*Labor mischarging*

The government contractor's labor charging process is a high-risk area given labor is often a significant expense of cost-reimbursable government contracts and the individual employees are an integral part of the process. The employees need to track and report their time accurately, and the contractor needs to provide a system that facilitates this. Government auditors have a prescribed set of requirements for timekeeping systems.

Timekeeping requirements include an adequate system that tracks labor hours by employee and contract, tracks and explains changes or omissions, and permits government auditors to verify labor charges. Inadequate labor charging can result in bid disqualification, contract adjustments or suspension, debarment, or false claims allegations.

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### *Accounting system inadequacy*

A government contractor's accounting system may not be capable of properly accumulating, recording, and reporting costs to comply with requirements for the type of contract awarded. Key requirements include but are not limited to the ability of the contractor's accounting system to:

- segregate direct and indirect costs
- accumulate and report costs by award
- accumulate costs in the same manner in which the project costs were proposed
- allocate indirect costs in an appropriate, consistent manner
- segregate unallowable costs for estimating, accumulation, and reporting.

Failure to maintain an adequate cost accounting system may adversely affect cash flow because the government may withhold payments and increase the frequency of contract audits. Additionally, an inadequate cost accounting system can increase the risk of violating the Truth in Negotiations and False Claims acts.

### *Davis-Bacon and Related Acts*

Davis-Bacon and Related Acts (DBRA) requires all contractors and subcontractors performing work on federal construction contracts in excess of \$2,000 to pay covered workers not less than the prevailing wage rates and fringe benefits for corresponding labor classifications employed on similar projects in the locale. Additionally, DBRA prevailing wage provisions apply to certain construction projects that are federally assisted through grants, loans, loan guarantees, and insurance. Noncompliance can result in financial impacts through correction of employee compensation and benefits, withholding of payments on government contracts, default for the covered contract, and suspension or debarment for gross offenses.

### *Cost allowability*

The FAR Part 31 includes a detailed description of direct and indirect costs that are deemed unallowable on government awards. Additional cost allowability factors to consider include (1) reasonableness; (2) allocability; (3) statutory and regulatory compliance; and (4) specific terms and conditions incorporated into the award. The impacts of noncompliance with cost principles range from disallowance of cost to payment of penalties to allegations of false claims.

### *Defective pricing*

A government contractor may be prosecuted if the federal government believes the contractor submitted defective cost or pricing data. Even if the failure to provide adequate information was simply an error, it may be considered defective pricing. The potential for a finding of defective pricing in a government audit and exposure to significant damages increases because of failure to properly assess pricing; ensure pricing is based on current, complete, and accurate information; and represent all facts known by the contractor at the time of price negotiation.



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### *False Claims Act*

This act is one of the hottest areas in government litigation, both federal and state. The act prohibits the intentional or grossly negligent use of erroneous or fraudulent data for the purpose of deceiving the government. Individuals may bring suit against fraudulent activity on behalf of the government and oftentimes, the Department of Justice joins the lawsuit against the contractor if the whistleblowers allegations are deemed systematic or material. The 2009 amendments to the federal legislation have given rise to the number of qui tam lawsuits filed by whistleblowers against corporations. One key change is the whistleblower is permitted to provide false claim information based on actual knowledge as opposed to hard evidence. Typical impacts of findings of false claims include civil and criminal penalties for individuals and civil and criminal penalties, as well as suspension or debarment, for the contractor.

### *Kickbacks*

Exchanges of cash, gifts, entertainment, employment of a friend or family member, or anything that could be considered of value between a government employee and a government contractor in exchange for favorable consideration are illegal activities. The federal statute has been enforced to ensure that government contractors prevent and monitor potential kickbacks at their business units. Typical impacts for providing kickbacks include civil and criminal penalties for individuals, and civil and criminal penalties, as well as suspension or debarment, for the contractor.

### *Bid rigging/collusion*

Government contractors need to ensure their employees and subcontractors refrain from all activities that could potentially be perceived as collusion on pricing, bidding, or marketing. The Sherman Antitrust Act of 1890 includes criminal and civil penalties for both the individuals and companies involved, in addition to suspension or debarment, termination of award, and increased public scrutiny, for government contractors convicted of bid rigging or collusion.

# *Government contracting practice services*



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PwC's Government Contracting practice (GCP) professionals have worked extensively with government contractors both in the public and private sectors, and we understand the financial and contract management requirements of state and federal contracting. This unique combination of government and industry experience makes our professional staff adept at working with clients to address their regulatory and business issues. As a result, clients receive clear, concise, fact-driven analyses and advice that meet their needs.

Our experience includes helping E&C companies. We customize the appropriate procedures for each engagement and consider the client's needs based on contract type, compliance requirements, and other identified risks. Following are examples of procedures we can perform:

- Assess the contractor's control environment and compare it to the various accounting and governmental compliance requirements.
- Evaluate the key accounting systems and subsystems, and identify gaps. Key subsystems can include:
  - labor charging and timekeeping
  - estimating system
  - procurement
  - billing
  - material management and accounting systems
  - expense reporting
  - contract and subcontract administration
  - unallowable cost
  - reporting
  - earned value.
- Assist a company entering into government contracting to structure an effective, compliant cost accounting approach, including evaluation of the pros and cons of various options.
- Prospectively analyze organizational changes, including their effects on the client's cost accounting methods, and the financial and regulatory consequences of such changes. This analysis is crucial to provide the client's management with decision-making information.
- Assist with preparing incurred cost submissions, a yearly requirement for contractors performing cost-reimbursable contracts. Our assistance typically includes helping clients develop systems and processes to identify and segregate unallowable costs.
- Analyze client contracts to identify unique or risky terms and conditions that could require the establishment of additional processes for compliance.
- Analyze functional departments and business practices to assist a client in optimizing cash flow through streamlining of estimating, cost accounting, and billing processes; negotiation of favorable business terms with customers and suppliers; and analysis of incurred costs to identify and reduce amounts not recoverable under applicable government cost principles. We can perform periodic evaluations of contract costs to identify current as well as future opportunities to increase recovery or cash flow through:
  - submission of unfiled change orders
  - improved billing processes
  - development of new pricing methods
  - negotiation of better financing and billing terms.
- Assist in assessment of allegations and development of responses, models to calculate damages, and disclosures if a government or other party alleges noncompliance with applicable laws and regulations. The most common allegations include false claims, defective pricing, and violations of the Buy American and Truth in Negotiations acts.
- Develop compliance programs to mitigate the contractor's risks through appropriate control processes, policies, and monitoring approaches. Critical to the compliance program is developing it within the contractor's framework and taking into consideration the company's systems, capabilities, and business strategy.
- Provide damage quantification and expert testimony in disputes between contractors or between contractors and the government.



# *Deliverables from our specialists*



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Each of the challenges and risk areas we've discussed demands an appropriate approach and response from any contractor wishing to comply, mitigate damage, and win government business. PwC carefully collaborates with each client to identify the company's individual issues and appropriate actions, defining the deliverables management will need to accomplish its goals. Key pieces help us establish successful engagement contracts:

- Statement defining the client's problem or goal.
- Outline of approach to address the problem or achieve the goal.
- Definition of the roles and responsibilities of personnel from PwC and the client in the engagement process.
- Description of final deliverables.
- Outline of timing, projected fees, and a mechanism for making mutually agreed-upon changes for required midcourse corrections, which can arise in any engagement.

Typically, our clients receive a report or memo that outlines: (1) procedures performed, (2) results of the procedures, (3) significant issues identified, (4) impact to the project's stated financial results, (5) impact to the project's other reporting results, (6) highlight of the issues' potential impacts to the overall business, (7) issues that warrant further consideration, and (8) recommendations on how to address identified issues and/or provide standard practices that can further improve the control environment.

However, we customize the deliverables to meet the client's needs. For example, a compliance gap analysis or evaluation of structural cost accounting alternatives could lend itself to an expert report or detailed presentation to client management. Another engagement, for assistance with preparation of a government filing or claim, might include a submission quality document or calculation that the client can fold into its own body of work or government communication.

Additionally, if the engagement requires providing assistance with government negotiations, such as an agreement on final indirect rates or resolution of an audit dispute, the client may instead decide to include PwC's GCP specialists as members of the internal strategy and negotiation team. In other cases, PwC's GCP services can result in an expert report and testimony to be relied on in legal proceedings.



# *Conclusion*







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A PwC subject matter specialist in government contracts can be an integral part of any active management initiative regarding government business. Working with you to address your needs, we tailor our involvement, from advising management to acting as the execution team. Because compliance issues may not always be anticipated, we are prepared to respond to clients' requests for assistance on a crisis basis to help them mitigate risk. We provide our clients with the leading advantage through industry insights and relevant knowledge of current issues to respond to the often challenging demands of contracting with the federal government.

We swiftly assess a client's need for assistance and propose a workable solution while providing the right knowledge and effort to get the job done.

PwC GCP has partner specialists across the United States:

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